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# Supreme Court of the United States

OCTOBER TERM, 1941

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No.....

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CHARLES B. RAYNER, *Petitioner*

vs.

UNITED NORTH & SOUTH DEVELOPMENT COMPANY

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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MAY IT PLEASE THE COURT:

Your petitioner, Charles B. Rayner, respectfully shows to this Honorable Court:

## Summary Statement of the Matter Involved

Petitioner sued respondent for actual damages, alleging that respondent had converted 11,709 shares of stock in respondent corporation, the conversion having occurred when respondent refused

petitioner's request to transfer the shares which had been duly endorsed in blank by Edgar B. Davis, the record owner thereof, and pledged by him to petitioner to secure certain promissory notes executed by Davis and payable to petitioner. (R. 1-5.) Demand for transfer was made after petitioner, upon default by Davis, had, as permitted by the pledge agreement (R. 30), sold the shares at public auction and bought them in himself. (R. 48-49.)

Respondent answered that it refused to make the transfer because Davis had notified it that his pledge of the stock to petitioner was not supported by an adequate consideration; because Davis had notified it that the foreclosure sale at which petitioner bought in the pledged stock was invalid and that the stock had sold for an inadequate price; and because the State of Massachusetts had impounded the stock by running a writ of garnishment on respondent to reach any stock in respondent owned by Davis. In connection with the garnishment proceeding it was alleged that the trial court had entered judgment quashing the writ of garnishment and discharging the garnishee, but that the State of Massachusetts had appealed from such judgment and that the appeal was pending at the time petitioner's demand for transfer was made. Respondent also alleged that in its refusal it relied upon the advice of counsel that it should not make the transfer in view of the claims made by Davis and in view of the garnishment proceeding. (R. 6-15.)

The trial judge (Judge McMillan) held that under the law of Texas respondent was liable for conversion for its refusal to transfer the stock. He found from uncontradicted evidence, or at least from the

great weight of the evidence, that in refusing to make the transfer, ostensibly because of Davis' claims and because of the appeal in the garnishment proceeding, respondent was not acting in good faith but was seeking to protect Davis, who owned 84% of its stock (R. 93), who was Chairman of its Board of Directors (R. 184), who "dominated and controlled the election of officers and directors . . . and the determination of employees, and has dominated and controlled the acts of the corporation" (R. 212); that its refusal to transfer the stock "was not done in good faith, but to obey the request of Davis and hinder Rayner (petitioner) in the collection of his debt" (R. 213); that respondent knew that "the reasons for refusal for such transfer did not in fact constitute valid reasons for such refusal" (R. 213); and further knew that Davis "had time and time again admitted the indebtedness, and that he had stated that he was going to pay it" (R. 213); and further knew that "his grounds of protest were frivolous" (R. 213).

Referring specifically to Ainsworth, Vice-President of respondent (R. 81), the trial court found:

"That H. M. Ainsworth, who on November 8, 1940, signed the letter of refusal on behalf of the company to transfer 11,709 shares of stock to C. B. Rayner, well knew of Davis' debt to Rayner, and of the pledge of 11,709 shares of stock by Davis to Rayner, and knew that such stock was duly indorsed by Davis for transfer on the books of the corporation; and that he had known such facts for many years, and knew that on many occasions Davis had acknowledged the validity of the debt and pledge, and many times had expressed an intention and desire to pay the same." (R. 212.)

The trial judge further found that petitioner's notes and pledge of stock were supported by an adequate consideration; that petitioner had full legal title to the stock at the time it was presented for transfer (R. 205-207, 214); and that this was known to respondent. (R. 213.)

On appeal these findings, fully supported by the evidence, were ignored by the Circuit Court of Appeals; that court disposed of the case as if the corporation had acted independently in good faith to protect its interest in view of the conflicting claims asserted as to ownership of the stock. The findings of the district court affirmatively show that the corporation was not acting independently of Davis but in concert with Davis. (R. 212-213.)

In its opinion the Circuit Court of Appeals takes that part of the trial court's oral opinion in which it is stated that "Ainsworth . . . had on prior occasion attempted to adjust the matter of Rayner's (petitioner's) claim for the purpose of getting it straightened out on Davis' behalf," and concludes that it "indicates that there had been a controversy between plaintiff (petitioner) and Davis with respect to the pledging of this stock." (124 Fed. (2d) 513.) This conclusion of the Circuit Court of Appeals is wrong; there has never been any such controversy. The trial court found that Davis had always acknowledged his debt to petitioner and had many times promised to pay it. (R. 207-208.) This finding is based upon undisputed evidence. (R. 179-183.) Furthermore, the evidence shows without dispute that Ainsworth's conversations with petitioner were not about the consideration for the notes, but were for the purpose of reaching some agreement

for the payment of Davis' *debt* to petitioner. Ainsworth was attempting to work out some settlement of an admitted obligation. (R. 193-194.)

The trial court held that the fact that a writ of garnishment had been run on respondent to impound Davis' stock in respondent did not justify respondent's refusal to transfer, since, at the time petitioner demanded a transfer, the writ of garnishment had been quashed and the garnishee discharged. He held that, under Texas decisions, this placed the parties in the same position they would have occupied had no writ ever been run; and that the fact that an appeal had been taken from the order quashing the writ and discharging the garnishee was immaterial because no supersedeas bond was filed, as required by Texas law, to preserve the status quo pending the appeal. (R. 202-203, 208-210, 214.) The Circuit Court of Appeals did not question this holding but held that the appeal of the garnishment proceeding and petitioner's demand for a transfer raised "a technical legal issue" that the officers of respondent were not called upon to decide. (124 Fed. (2d) 513.)

**Reasons Relied Upon for the Allowance of the Writ**

1. Jurisdiction in this case rests upon diversity of citizenship, and the legal issues presented must be decided in accordance with the law of Texas. The Circuit Court of Appeals, in reversing the trial court's judgment, refused to follow the law of Texas in the following respects:

(a) Under Texas decisions the refusal of a corporation to transfer stock properly endorsed for transfer gives the party making the request the

option of compelling a transfer through a mandamus proceeding, or of recovering damages caused by the corporation's conversion of the stock. *The Rio Grande Cattle Co. v. Burns, Walker & Co.*, 82 Tex. 50, 57; *Bower v. Yellow Cab Co.*, 13 S. W. (2d) 708 (Tex. Civ. App.); *Gresham v. Island City Savings Bank*, 21 S. W. 556 (Tex. Civ. App.). The trial court so held. (R. 203.) The Circuit Court of Appeals held, contrary to the Texas rule, that respondent's refusal to transfer petitioner's stock relegated petitioner to a mandamus proceeding; that petitioner had no choice between such a proceeding and an action for conversion.

(b) Under Texas decisions the good faith of the defendant is no defense in an action for damages for conversion where only actual damages are sought. *Pecos & N. T. Ry. Co. v. Porter*, 183 S. W. 98, 102 (Tex. Civ. App.). Admitting for the sake of argument that respondent acted in good faith in refusing to transfer petitioner's stock, and ignoring the trial court's unimpeached findings to the contrary, the fact remains, nevertheless, that the Circuit Court of Appeals failed to follow the Texas decisions holding that the question of good faith is immaterial.

(c) The above principles are applicable here because under Texas decisions a corporation requested to transfer stock may be called upon to decide "technical legal issues," and may be held liable in damages for conversion if it refuses to transfer after reaching an incorrect decision as to the "technical legal issues." *The Rio Grande Cattle Co. v. Burns, Walker & Co.*, 82 Tex. 50. In that case the corporation was held liable in damages for refusing

to transfer stock where its refusal to transfer was based upon the belief that a certain written instrument entered into by the incorporators turned the corporation into a partnership. The court, in its opinion, admitted that the "agreement under consideration in many of its features assimilates nearer to a partnership in defining the rights and duties of its members than to a corporation" (82 Tex. 55); but held, after some hesitation, that the corporate entity was unaffected by the agreement; and further held the corporation was wrong in its legal conclusion, and liable for conversion for its refusal to transfer.

The Circuit Court of Appeals refused to follow the above holding, and held that respondent rested under no duty to transfer petitioner's stock because petitioner's demand for the transfer raised "technical legal issues" which the officers of respondent were not called upon to decide.

(d) Under Texas decisions the corporate fiction will be disregarded where necessary to prevent fraud. *First National Bank in Canyon v. Gamble*, 134 Tex. 112, 119-120; *Pacific American Gasoline Co. of Texas v. Miller*, 76 S. W. (2d) 833, 851 (Tex. Civ. App.). The trial court followed those decisions and examined into the relationship between Davis and his corporation. He found that Davis controlled respondent and that respondent did his bidding in refusing to transfer petitioner's stock. The Circuit Court of Appeals, on the other hand, completely ignored Davis' domination of respondent and the fact that respondent did his bidding in refusing to transfer petitioner's stock. Consequently, even if, contrary to the Texas decisions, the question of good faith was material, the Circuit Court

of Appeals erred in holding that the issue of good faith should be determined without examining into the relationship between Davis and his corporation.

(e) Under Texas decisions petitioner, a pledgee of stock properly endorsed for transfer, had the right to have the same transferred on the books of respondent corporation, irrespective of whether or not there had been a foreclosure of the pledge lien. *Seeligson & Co. v. Brown*, 61 Tex. 114, 117; *Cavitt v. Gulledge*, 255 S. W. 784, 787 (Tex. Civ. App.); *Davis v. Hardwick*, 94 S. W. 359, 361 (Tex. Civ. App.). Consequently, the Circuit Court of Appeals erred in giving consideration to the fact that petitioner bought in the stock at the foreclosure sale at a price considerably lower than its real value (124 Fed. (2d) 513), this having occurred because of Davis' action in notifying prospective purchasers that, if they bought the stock, they would be buying a lawsuit. (R. 49-51.) As petitioner had the right to have the stock transferred, irrespective of the foreclosure sale, what occurred at the sale was immaterial. Furthermore, under Texas decisions, petitioner, the pledgee, having bought in the stock, Davis must be credited on his notes with an amount equivalent to the actual value of the stock at the time it was sold, irrespective of the actual selling price. *King v. D. Sullivan & Co.*, 92 S. W. 51, 52-53 (Tex. Civ. App.). Therefore Davis cannot possibly be prejudiced by the price at which petitioner bought in the stock.

2. The decision of the Circuit Court of Appeals in this case is in conflict with the following decisions of other Circuit Courts of Appeals:

(a) *London, Paris & American Bank v. Aronstein*, 117 Fed. 601 (9th Circuit), cert. den. 187 U. S. 641, in which case a corporation was held liable in damages for refusing to transfer stock upon demand of an executor under the belief that the law of England, which required that the decedent's estate be administered upon at the domicile of the corporation in England before a transfer could be made, was controlling. The court held, in four pages of legal reasoning, that certain provisions in the California Constitution applied and overrode the law of England which would have required administration of the decedent's estate in England. That case shows clearly that the fact that a demand for the transfer of stock raises "a technical legal issue" will not excuse the corporation for its refusal to transfer. The corporation must decide the technical legal issue and must decide it correctly. As pointed out at pages 6-7 *supra*, the Texas rule is the same. The Circuit Court of Appeals held the contrary.

(b) *O'Neil v. Wolcott Mining Co.*, 174 Fed. 527, 533-534 (8th Circuit), in which case the court held that a corporation, if confronted with conflicting claims to certain stock and a demand for its transfer, "cannot assume the functions of a Court and by their determination conclude the rights of the parties; and if resort is not had to the Courts within a reasonable time by the corporation or the protestant to determine the rights of the parties, it becomes the duty of the corporation to register the stock in the name of the first claimant." With reference to the naked claim of a third party, the court stated: "The corporation when it refuses, and upon

the trial of the issue the court, must be able to see from the facts established that there is some question to be tried. The mere claim of the stock is not sufficient."

In the instant case respondent took the position that Davis' claims relieved respondent of all duty in the premises. It did not file an interpleader suit; it did not get Davis to file any character of suit; and it did not even produce Davis as a witness at the trial to substantiate his claims, although he was available as a witness and although the respondent was relying upon the claims made by him. (R. 142, 195-196.) The Circuit Court of Appeals held that respondent rested under no duty to take any action whatsoever.

3. The opinion of the Circuit Court of Appeals is not supported by the authorities therein cited and is in conflict with the weight of reasoned authority, authority which it must be presumed the Texas courts would follow, in the following respects:

(a) The general rule is that a corporation, if confronted with conflicting claims to certain stock and a demand for its transfer, must either file an interpleader suit to get the question decided, get the adverse claimant to file some character of suit that will get the question decided, or transfer the stock to the first claimant. *State ex rel. v. McIver*, 2 S. C. (2 Rich.) 25, 44; *Spangenberg v. Nesbitt*, 22 Cal. App. 274; *O'Neil v. Wolcott Mining Co.*, 174 Fed. 527, 533-534 (8th Circuit); the general rule is laid down in 18 C.J.S., Corporations, sec. 435, p. 1051, one of the authorities relied upon by the Circuit Court of

Appeals. As pointed out at page 9, *supra*, this is the Federal rule. The Circuit Court of Appeals held, on the contrary, that Davis' claims relieved respondent of all duty in the premises; that it was unnecessary for respondent to file an interpleader suit or to get Davis to file some character of suit.

(b) The general rule is that a corporation refusing to transfer stock must notify the party seeking the transfer of the reasons for its refusal, and that any reason not assigned at that time is waived and cannot be set up thereafter. *Tobias v. Wolverine Mining Co.*, 52 Idaho 576, 585-586; *In re Klaus*, 67 Wis. 401, 402-403; *Spangenberg v. Nesbitt*, 22 Cal. App. 274, 280; Christy, *The Transfer of Stock*, page 466. The Circuit Court of Appeals held, on the contrary, that Davis' claim that his notes and pledge of stock were not supported by an adequate consideration and that the stock sold for an inadequate price justified respondent in refusing to transfer petitioner's stock although no mention of those defenses was made by respondent when it refused to transfer the stock. (R. 59-60.)

(c) The authorities cited by the Circuit Court of Appeals do not sustain its decision. Two of the authorities, 18 C.J.S., Corporations, sec. 435, and the case of *Spangenberg vs. Nesbitt*, 22 Cal. App. 274, are discussed above. Those authorities, insofar as they bear upon the question of adverse claims to corporate stock, fully support petitioner's position.

*Shear Co v. Wilson*, 292 S. W. 531 (Tex. Com. App.), another case cited by the Circuit Court of Appeals, merely holds that where the president

of a corporation had sold 50 shares of its stock to Mrs. Wilson and had endorsed such certificate in blank, the corporation was on notice that Mrs. Wilson was the owner of the certificate, and when the certificate was presented for transfer by another, there being no endorsement by Mrs. Wilson thereon, the corporation was liable for conversion in reissuing the stock to such other person.

In *Bayard v. Bank*, 52 Pa. St. 232, another case cited by the Circuit Court of Appeals, it was held that the corporation had the right to refuse to transfer until the trustee who had demanded the transfer showed his authority under the trust indenture to make the sale and to demand the transfer.

In *Howe v. Roberts*, 209 Ala. 80, another case relied upon by the Circuit Court of Appeals, an action had been brought in equity to compel a transfer of stock by the corporation. The court stated that in its opinion such a procedure was an ideal one.

WHEREFORE, petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket 10038, United North & South Development Company, Appellant, vs. Charles B. Rayner, Appellee, and that the judgment of the United States Circuit Court of Appeals for the Fifth Circuit may be reversed by this Honorable Court and that of the district court

affirmed, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

CHARLES B. RAYNER, Petitioner
*By* JAMES D. WILLIAMSON
JOHN W. STAYTON
Counsel for Petitioner

BLACK, GRAVES & STAYTON
Of Counsel